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STATE PASS TO USTR PBURKHEAD

E.O. 12958: DECL: 09/28/2019
TAGS: ETRD ECON PREL AG
SUBJECT: ALGERIA: FINANCE MINISTER BACKS ALGERIA'S NEW
INVESTMENT RULES

Classified By: Ambassador David D. Pearce; reasons 1.4 (b) and (d).

SUMMARY

¶1. (C) Minister of Finance Karim Djoudi told USTR Director for the Middle East and Europe Paul Burkhead September 28 that the purpose of Algeria's new rules on imports and foreign investment was to lower imports, tighten control on hard currency outflows, reduce tax fraud, and protect and promote domestic industries. Only a strong industrial base could make Algeria an equal partner with other economies. Djoudi asserted that rising imports threatened economic stability, and that the state had a responsibility to manage the transition to a free market economy. Burkhead cautioned that Algeria's new investment rules created an unpredictable business climate and would deter investors. Djoudi thought that Algeria would apply these measures for a limited period, until domestic industry was stronger and the balance of payments more favorable.

¶2. (C) Summary continued: Burkhead emphasized our interest in expanding bilateral trade and investment cooperation outside the hydrocarbons sector, and suggested bilateral talks under the 2001 Trade and Investment Framework Agreement (TIFA). The U.S. stood ready to assist Algeria with its WTO efforts. Djoudi agreed that the TIFA could be a useful mechanism for regular dialogue. He asserted that WTO accession remained a goal for Algeria, but complained that the bar to WTO kept moving higher. Algeria needed ''balanced'' conditions for accession that fell short of full liberalization and permitted for a certain period the kind of measures Algeria had just introduced. END SUMMARY.

FOREIGN INVESTMENT, ON ALGERIA'S TERMS

¶3. (C) During a September 28 meeting, Finance Minister Karim Djoudi told USTR Director for the Middle Eastern and European Trade Affairs Paul Burkhead that the United States was a strategic economic partner for Algeria. Djoudi said that Algeria's investment policies aimed to diversify the economy while addressing the country's social development needs. In an overview of Algeria's macroeconomic situation, Djoudi said foreign exchange reserves now equaled three years of imports, external debt was about 1 percent of GDP, and the country's stabilization fund was valued at 40 percent of GDP. Djoudi said that growth outside the hydrocarbons sector was 6 percent and that unemployment had decreased from 30 percent to 11.3 percent. He attributed lower unemployment to a 55 percent increase in jobs, 85 percent of which, he said, were created in the private sector.

¶4. (C) Djoudi said that unchecked imports posed a threat to Algeria's economy. The country's import bill had grown from USD 20 billion in 2006 to USD 39 billion in 2008. Imports of

services had seen a particularly sharp spike. Algeria's economic strategy had to balance international trade rules with the need to promote national industries, which he said was the reasoning behind new investment rules included in the 2009 complimentary finance law (CFL). In the medium-term, Algeria planned to follow an infant industry strategy to boost export capacity in key industries and replace certain imports. He argued that Algeria had to be a producer and not devote itself to ''pure commerce.''

¶5. (SBU) Djoudi said the CFL measures sought to encourage investment and tighten controls on hard currency outflows and prevent abuses. The requirement of a 51 percent Algerian partner majority stake in all foreign investments would keep more profits in Algeria, as would the requirement that all foreign investment maintain a positive hard currency balance. The letter of credit imposed as the sole method for financing imports would reduce the scope of over-invoicing and false import declarations. Firms should reinvest a portion of profits in the local economy, he said.

¶6. (C) Burkhead told Minister Djoudi that foreign direct investment was the key to diversifying Algeria's economy away from energy. U.S. firms operating in Algeria and many potential U.S. investors were concerned about the CFL measures. The key problem was a lack of predictability in the business climate. Several CFL measures had caught foreign companies by surprise. Burkhead said the 51 percent

partnership rule for foreign investment and the 30 percent partnership rule for foreign import companies could hinder Algeria's ability to attract foreign investment. Burkhead explained that foreign investors do not want to cede control of their investments to local partners. Some might opt to

curtail their operations or forgo future investments.

¶7. (C) Djoudi replied that the CFL measures were only adjustments to existing policy and not an overhaul of Algeria's investment laws. He claimed that Algeria recognized the importance and the role of foreign investment in economic development. Djoudi noted, however, that global economic factors, particularly lower world oil prices, have impacted Algeria's economy. Oil and gas exports in 2009 were 50 percent lower compared to the same period last year. Djoudi said that under the 51 percent rule, foreign companies could partner with several Algerian firms, leaving the foreign investor with a relative majority that would give it authority over management and dividend distribution policies. As to the 30 percent rule, Djoudi said it would only apply to foreign firms that imported finished goods. Burkhead replied that most U.S. firms would not invest in any undertaking with less than a 51 percent share.

¶8. (C) Burkhead told Djoudi the U.S. shared Algeria's goal of building a robust, diverse economy, but Algeria's recent actions looked more like a return to a state-controlled system. Djoudi admitted that the state was becoming more involved in economic matters, but argued that the state has a responsibility to manage the transition to a free economy. Djoudi said Algeria's IMF-prescribed economic liberalization in 1994 had caused a sharp fall of the dinar and the failure of many state companies, depriving Algeria of much of its industrial base. Today few Algerian firms were internationally competitive. Djoudi said the government would impose these measures for a time so that Algerian companies could increase their competitiveness and put themselves on a equal footing with foreign firms.

REVITALIZING TIFA

¶9. (C) Burkhead told Djoudi that one of the goals of his visit was to look for opportunities to expand our bilateral engagement on trade and investment. He noted that in the past two years there had been little dialogue with Algeria on these matters. The bilateral council established by our 2001 Trade and Investment Framework Agreement (TIFA) had been

inactive for several years. As a way forward, Burkhead proposed revisiting the TIFA framework to guide regular bilateral meetings on bilateral trade and investment issues. Djoudi welcomed the offer.

NO SHORT-TERM FIX FOR WTO OR PHARMA BAN

¶10. (C) Djoudi reaffirmed his government's goal of joining the WTO, noting that Algeria had put a lot into that effort, and had also concluded an Association Agreement with the European Union. Djoudi said there are monthly discussions on WTO with Prime Minister Ouyahia, but the general sentiment within the government was that for every concession Algeria made on liberalization, WTO just demanded more. Djoudi believed that Algeria had overcome the major obstacles to membership, citing better access to Algeria's services sector, and suggested that any remaining concerns could be addressed after Algeria became a WTO member.

¶11. (C) Burkhead agreed that WTO accession was a long and frustrating endeavor. The requirements for joining tended to increase with time as membership grew and trade policies became more liberal. Nonetheless, the U.S. wanted Algeria to succeed and stood ready to offer advice and assistance to reinvigorate Algeria's WTO bid. Burkhead cautioned that decisions such as the CFL measures would complicate the negotiation process and raise concerns among WTO members. He added that the government's import ban on pharmaceuticals contradicted the basic WTO principle of lowering trade barriers. Each WTO applicant country had to comply with the same set of standards. "Algeria is well positioned to take a leadership role in the WTO, but needs to address the basics first," Burkhead concluded. Ambassador Pearce said another important benefit, sometimes overlooked, is that membership would give Algeria a seat at the table and hence the ability to influence the WTO framework.

¶12. (C) Djoudi noted both points and stated a belief that the essential work for Algeria's WTO accession was already complete, allowing it to focus on remaining issues gradually. On pharmaceuticals, Djoudi understood the ban was somewhat contradictory to Algeria's WTO aspirations, but the decision only banned the import of medications produced domestically. Furthermore, foreign pharmaceutical firms were welcome to

partner with an Algerian operator to produce medications locally. As with trade in other areas, Djoudi said, Algeria had to break the ''vicious circle'' of excessive imports, which created no wealth, and expand the domestic pharmaceutical industry. He hoped WTO discussions would agree on a ''balance'' short of full liberalization that could offer partners such as the U.S. certain advantages.

NABORS DRILLING

¶13. (C) Ambassador reminded Djoudi of the 20 million dollar fine that Algerian Customs had imposed in 2007 against U.S. oil service company Nabors Drilling for moving a rig without formal approval from Customs. Nabors' appeal had yet to be resolved. The Ambassador said this was an extremely punitive judgement. He recognized the need for companies to comply with customs regulations, but pointed out that, as a practical matter, it was extremely expensive to keep a drilling rig idle for a prolonged period when there were excessive delays in processing paperwork. It was a cost borne not only by the company concerned, but equally if not more by Sonatrach and Algeria because it meant that the rig was not working to produce oil and gas. Nabors was a reputable firm and a significant commercial partner in Algeria; it had drilled about ten percent of Algeria's wells. The Ambassador emphasized the need for a quick decision and asked Djoudi to review the case. Djoudi remembered the issue from a previous conversation with the Ambassador and admitted that administrative requirements sometimes are not compatible with efficiency. While he took the point about business efficiency, he said that Customs was also correct to enforce

its regulations. That said, he noted that a compromise solution had been found in a similar Bechtel case, and he was hopeful this case could also be settled in a satisfactory manner.
PEARCE